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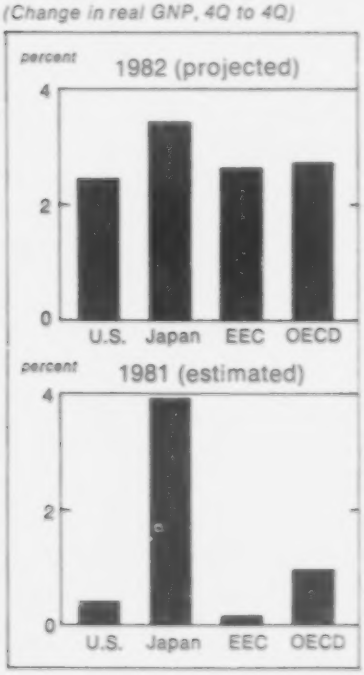
The World Economy in 1982—No Replay of 1981

The performance of the world economy is likely to improve significantly in the coming year. On a fourth-quarter to fourth-quarter basis, real output in the OECD countries should increase by roughly 2½% in 1982, distinctly better than the 1.0% growth achieved last year, but insufficient to prevent an increase in the overall OECD unemployment rate. Measured on a yearly average basis, however, the increase in OECD growth will appear to be insignificant—1.3%, compared with 1.0% in 1981. World trade volume, flat last year, will grow by about 2%. And inflation rates will fall in virtually all OECD countries. The major industrialized economies will not be closely synchronized over the first half of the year. The United States is entering the new year amidst a sharp recession; in Europe the first signs of an upturn are already apparent. By midsummer, however, recovery should be well under way in most of the industrialized countries, with growth in the United States outpacing Europe, and possibly even Japan, in the second half of the year.

Projected economic growth in 1982 compared with 1981
(Change in real GNP, 4Q to 4Q)



The 1982 outlook is not all that different from the forecast for 1981 that appeared here a year ago—a projection that proved much too optimistic. The key source of error in last year's outlook was the failure to foresee the persistence of unprecedentedly high U.S. interest rates, a development that led in turn to a remarkable strengthening of the dollar and a defensive tightening of fiscal and monetary policies in Europe and Japan. These high interest rates resulted from the collision between a Federal Reserve dedicated to stricter control of money growth and an economy that proved extremely reluctant to revise its inflation expectations. The obvious question is whether history will repeat itself, with tight monetary conditions short-circuiting the upturn in the United States, and the global economy continuing in the stop-go pattern of the past two years.

The judgment here is that the inevitable re-tightening of U.S. monetary conditions later this year will not be so severe as to prevent a significant recovery in real output. The key difference between this year and last is the shift in inflation expectations. There is increasing evidence that price expectations in the United States are being revised downward. If this development continues, the coming year will not be a replay of 1981, and the global economy will at long last begin a slow but reasonably sustained recovery from the world recession set off by the second round of oil-price increases.

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WESTERN EUROPE

Although the recession in Western Europe has bottomed out, the upswing currently under way is expected to be one of the slowest on record. The sluggish recovery reflects the changed attitudes of many European economic policymakers, who are reluctant to adopt expansionary fiscal and monetary policies for fear of worsening already-high inflation rates and widening balance-of-payments deficits. Thus, barring governmental stimuli, growth in Western Europe will depend first on an end to the rundown of inventories, subsequently to some stockbuilding, and later to growing exports and rising consumption—a process that is likely to be extremely slow.

In the **United Kingdom,** the government continues to hold to its restrictive fiscal and monetary stance, although both public expenditure and money supply growth remain well above target. There are signs that the economy's steady decline since mid-1979 has halted and that the country is now set to resume slow growth. Firms have shed a lot of surplus labor, and productivity has began to rise—a trend that should accelerate as output expands. Inflation remains high, but this year's wage round has begun well, and it appears that single-digit earnings growth will be the norm. This would contribute to a 1982 inflation rate only slightly above 10%, accompanied by positive real economic growth of about 0.7%.

A consumer-led recovery is expected to boost real GDP in **France** by nearly 3% in 1982, although an average inflation rate approaching the 13.5% posted in 1981 is forecast. The growth resurgence is projected to widen the current-account deficit to about 60 billion francs from 35 billion francs in 1981.

After strong growth in 1980 and early 1981, business activity in **Switzerland** is now in a pronounced downspin. Real GDP growth of no more than 0.5% is expected in 1982, although the current-account surplus should widen to 5 billion Swiss francs from SF 2 billion in 1981. Inflation is expected to fall sharply over the course of the year, helped by the economic contraction and a strong franc, but the average rate will approach 6%.

West Germany's recovery is not expected to gather steam until midyear, although a weaker U.S. dollar would accelerate the expected reduction in interest and inflation rates and spur a faster recovery. Real growth of 1.5% is forecast for 1982, after a slight contraction last year. The inflation rate is expected to drop to 5%, and the current account is likely to post a small surplus, the result of heightened export competitiveness and improved trade terms.

Italy continues to suffer a large balance-of-payments deficit, a major short-term constraint on its growth. Real GDP is expected to increase by about 1% this year, with monetary policy continuing restrictive. The current-account deficit is forecast to narrow to $6 billion from $10 billion last year. Inflation is projected to drop slightly to 17%.

The **Scandinavian** economies, whose business cycles usually lag those elsewhere in Europe, are more closely synchronized in the current environment. **Denmark, Norway,** and **Sweden** are expected to see growth pick up from its 1981 pace. But **Finland's** economy may slow slightly in response to restrictive policies to quell economic overheating in 1979-80.

WESTERN HEMISPHERE

As a consequence of the U.S. and world economic slowdown, **Canada's** real GDP grew by only 2% in 1981, with the likelihood of an even slower pace in 1982 induced by a restrictive federal budget. Inflation averaged nearly 13% last year, but the expectation of smaller food price rises could reduce the inflation rate in 1982.

For the Latin American-Caribbean region, 1981 is likely to be remembered as one of the poorest years in recent economic history. Real economic growth region-wide is estimated at 1.5% at best, versus 5.4% in the previous year. The reasons include the recession in the industrialized world, worsening terms of trade, rising interest rates, and generally more restrictive demand-management policies aimed at checking inflation and balance-of-payments deterioration. In Central America, the principal cause of the economic slowdown in 1981 was widespread political disturbance. The Latin American outlook for 1982 is for a rise in the rate of real growth to about 3%, still well below the 4.8% annual average growth rate between 1975 and 1979. The growth expected will be based largely on the recuperation of the Argentine and Brazilian economies and continued strength in Mexico, the countries contributing most to the region's GDP.

Argentina will face an uphill battle in achieving positive economic growth and lower inflation after the output decline and price surge in 1981. **Brazil** recorded a large trade surplus and cut its inflation rate in 1981, but at the cost of a recession; real GDP is likely to recover in 1982, however. And **Mexico** will see its real economic growth rate slow slightly to a still-strong 6% in 1982.

In the Andean Group, **Venezuela** should experience growth of some 2%—if steps are taken to reactivate the economy after three years of stagnation; inflation is likely to stabilize at around 10%. **Ecuador** will attempt to stimulate new oil output to boost its lagging economy. Although **Colombia** experienced a business slowdown last year, the implementation of large investment projects brightens 1982 prospects. In **Peru,** growth is not likely to exceed the 4.5% rate of 1981, and inflation is expected to continue high in light of a large fiscal deficit. A period of economic stagnation is seen for **Chile,** with the inflation outlook dependent on exchange-rate policy. **Uruguay's** economy is also expected to show no growth in 1982, while the **Paraguayan** economy is expected to proceed on a sustained, albeit modest, growth path.

The Central American outlook is bleak. **Nicaragua's** recovery is proceeding slowly, hampered by political uncertainty and a foreign-exchange squeeze. Civil unrest in **Guatemala** and **El Salvador** is worsening, while **Honduras** is plagued by its proximity to the trouble spots. And **Costa Rica** is seeking to reschedule its foreign debt of $2.6 billion. **Panama** stands apart, with favorable growth prospects for 1982.

In the Caribbean, **Trinidad** and **Tobago** will continue to realize solid gains from oil and gas, while the **Bahamas** should experience a tourism revival by late 1982. The **Dominican Republic's** external-payments situation may continue to worsen this year, given the sugar price outlook. **Jamaica's** economic recovery is proceeding slowly, while **Puerto Rico's** economy is expected to stagnate in response to U.S. weakness.

ASIA-OCEANIA

The major impetus to **Japan's** growth in 1982 is likely to be domestic demand, in contrast to the export-led growth of the last two years. The pickup in domestic demand, however, is unlikely to compensate fully for the expected slowdown in net exports, and real growth will probably total only about 3.5% this year. Inflation will remain moderate, with consumer prices forecast to rise by an average of 3%-3.5%. The yen's appreciation, the sluggishness of the U.S. and European economies, and strong protectionist pressures will result in much slower export growth this year. But with import growth likely to remain moderate, the current-account surplus is expected to widen to about $12-15 billion from $6 billion in 1981.

South Korea should experience a second year of recovery from its 1980 recession, and real economic growth of 6%-7% can be expected in 1982. The current-account deficit, nevertheless, will remain at about $5 billion, and the inflation rate is forecast to stay at well over 10%. **Taiwan's** economic growth rate is also projected at 6%-7%, but its deficit on current account is not expected to top $1 billion and inflation should be in single digits. **Hong Kong** may have problems sustaining its recent 8%-10% growth rate, with its exports under strong competitive pressure. **Singapore's** role as a service center for the oil industries of Indonesia and Malaysia makes it less vulnerable; real growth of over 8% is possible in 1982.

The **Philippines** continues gripped by recession. In the absence of a rise in the prices of its main export commodities, growth in 1982 will be less than 3%, with a large balance-of-payments deficit likely. **Thailand's** excellent crops in 1981 should support export volume this year, while the new gas pipeline from offshore fields will limit oil imports. Consequently, a modest improvement in the payments balance is forecast, with overall growth of 6% and inflation of 10%. **Malaysia** is expected to sustain a stable growth rate of around 7.5%, with its current account in near balance. **Indonesia** is in the midst of a large capital spending program, and, with stable oil earnings, its current-account deficit could reach $3 billion this year. Although there have been calls in **China** for a shift of resources back to heavy industry and construction, Premier Zhao has supported a plan and budget for 1982 that maintain strict budgetary controls. Moderate economic growth of 4% is projected for 1982.

The pace of resource development will be the primary determinant of economic growth in Oceania. Real economic expansion in **Australia** is likely to total 3.5%-4%, inflation is expected to be around 11%, and a large current-account deficit is forecast. In **New Zealand,** real growth of only 1.5%-2% is probable, but inflation may exceed 15%.

MIDDLE EAST-AFRICA

Sluggish world demand for OPEC oil resulted in smaller price rises and an output reduction of 15% in 1981. The OPEC surplus on current account narrowed to an estimated $65 billion from $108 billion in 1980. Continued weak demand for OPEC oil, coupled with the freeze imposed on oil prices, will shrink the OPEC surplus further to no more than $40 billion in 1982.

Although **Saudi Arabia's** oil revenues will fall noticeably this year, its outlays for development and national defense will accelerate in the context of a new five-year plan. Despite lower petroleum earnings, government spending will also remain buoyant in the **UAE** and **Oman.** In **Kuwait** and **Qatar,** however, public-sector outlays will be restrained in 1982. **Tunisia's** prospects are brightened by two oil finds and more direct investment by Arab oil exporters. But despite the expected growth of phosphate exports, **Morocco's** economy will be hurt in 1982 by a prolonged drought that will boost food imports and expand the trade deficit. And **Egypt's** current-account gap will widen substantially this year because of slower export growth. **Iraq's** development drive has continued unabated, financed by exports through the Mediterranean pipelines and heavy Arab aid. **Iran's** position is weaker, but recent oil export increases have helped. The lack of agreement over gas export prices and soft oil demand have weakened **Algeria's** external position. **Syria's** balance of payments is similarly weak, but the **Jordanian** economy has continued to prosper, thanks to aid grants and remittances. In **Israel,** inflation could average above 100% in 1982, barring new, well-defined policy initiatives.

Slower growth, deteriorating terms of trade, and rising external-debt loads characterized the economies of Sub-Saharan Africa in 1981. Regional real GDP growth, 4.7% last year, is projected to decelerate to 3.5% this year, with poor prospects for African raw materials exports. With the exception of the minor oil producers—**Angola,** the **Congo,** and **Gabon,** which posted current-account surpluses last year—current-account deficits elsewhere in Africa widened, and little if any improvement is seen for 1982. The two major economies, **Nigeria,** and **South Africa,** saw their current accounts swing from $3.4-billion surpluses each in 1980 to deficits of more than $8 billion and $5 billion, respectively, last year, as Nigeria's oil receipts shrank because of reduced demand while South African gold earnings suffered. This year, reduced imports should trim the deficits, with foreign capital providing the needed finance. Most African economies, however, face another year of continued heavy dependence on concessional aid, with the IMF's supervisory role widened.

COMMODITIES

The worldwide economic slowdown is reflected in sagging international commodity prices. Industrial commodity markets continue to suffer from slack demand and producer overcapacity, while the outlook for agricultural commodities is dominated by abundant harvests and burgeoning supplies.

The growing consensus that any turnaround in the industrial economies is likely to be tenuous—at least until midyear—suggests that the industrial metals face a six-month period during which demand will continue quite weak. A slow recovery is expected for **aluminum,** in light of record stocks and perhaps the worst recession the industry has ever known. Despite significant price cuts, the **nickel** market is expected to remain in the doldrums as long as the steel industry continues depressed. Strikes in North America and Ireland enabled **zinc** producers to raise prices substantially last year, despite weak demand; however, prices now appear to be leveling off. In the depressed **copper** industry, stocks are abnormally low, owing to high interest rates, and there is some chance of a sharp rise in prices should the economy show unexpected vigor. Given the prospect of continued sales of **tin** from U.S. stockpiles in an already thin market, prices are likely to remain under downward pressure. In the **lead** market, strikes and lower supplies of scrap have trimmed stocks, suggesting price firmness.

High interest rates, progress in stemming U.S. inflation, and a strengthening of the dollar over the past year have helped bring **gold** and other precious metals prices more in line with supply and demand fundamentals. Oversupply in the **silver** market is likely to keep prices near their current low levels. No strong rebound in **platinum** prices is expected as long as the U.S. auto industry remains depressed.

World grain production, including **wheat, rice,** and **coarse grains,** is expected to set new records, while grain consumption will show a more modest rise, leading to downward pressure on prices. Higher **poultry** consumption, as well as the general weakness of the developed economies, continues to discourage demand for **beef** and **pork.**

Aided by government subsidy programs and near-ideal growing conditions, the 1981-82 **sugar** harvest will set a new record, suggesting little if any price recovery in 1982. Since consumption will fall far short of this year's bumper **coffee** crop, prices are likely to remain weak. And **cocoa** price softness will continue in view of a fifth consecutive surplus season.

Sluggish textile activity, combined with bumper crops in the United States and China, will keep **cotton** prices down early in the year, although they may rise slightly if the world economy improves. And **rubber** prices seem likely to stay low in the near term.

Latin America Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS		GNP IN 1980		BALANCE OF PAYMENTS						MONEY AND BANKING							COUNTRIES
		6 months ending	change from year earlier	in billions of dollars	per capita	latest data	reserves (less gold) in million $	12-month change	months of imports covered	use of IMF credit, millions of dollars	current influences on payments	12-month changes: latest data	12-month changes: consumer prices	12-month changes: latest data	12-month changes: money supply(M1)	exchange rate in U.S. dollars December 29, 1981	change from year earlier	current monetary conditions	
Argentina	New president cites fiscal austerity and cut in state role in economy as major goals.	Mar.	— 8%	117.0	$4,333	Aug.	3,751	—60%	5.0	0	Unified foreign-exchange market replaces two-tier system.	Nov.	+120%	Oct.	+127%	.00014	—72%	Banks may accept fixed-term, foreign-currency deposits.	Argentina
Bahamas	Economic slowdown precipitated by tourism decline, but construction holding up.	Mar.	— 9%	1.2	5,630	Oct.	127	+27%	1.9	0	Tourism earnings declining because of U.S. recession and dollar appreciation.	Aug.	+ 10%	June	+ 10%	1.01	0	Liquidity at low level.	Bahamas
Barbados	Oil imports to cost $40 million this year; government giving priority to energy conservation measures.	June	— 3%	0.8	3,055	Oct.	64	—28%	1.4	2	Imports and exports in first-half 1981 up 11.8% and 11% from year ago.	Aug.	+ 14%	Aug.	+ 13%	.4972	0	Discount rate raised to 22%.	Barbados
Brazil	Adjustment program producing lower inflation, but GDP growth in 1981 was either zero or negative.	Oct.	+10%	233.2	1,896	Oct.	5,468	0	2.7	0	Balance of payments improving as consequence of stabilization measures.	Nov.	+ 99%	Nov.	+ 66%	.0079	—51%	Liquidity supply expands slightly.	Brazil
Chile	Central bank has assisted eight financial institutions; several major companies bankrupt.	Sept.	—14%	22.8	2,060	Oct.	3,317	+13%	5.2	54	New mining law and associated laws approved to spur foreign investment.	Nov.	+ 14%	July	+ 70%	.0260	0	Interest rates rising.	Chile
Colombia	Cumulative inflation rate for first 10 months of 1981 rose to 22.6%; food items posted biggest rise.	June	—39%	36.8	1,360	Oct.	4,501	— 4%	10.7	0	Current-account gap of $591 mn. for Jan.-Aug. 1981 vs. surplus year earlier.	Oct.	+ 26%	Apr.	+ 25%	.0200	0	Effective interest rates reach 50%.	Colombia
Costa Rica	Government having problems renegotiating $2.6-billion foreign debt.	June	— 1%	5.0	2,190	Oct.	101	—32%	0.9	106	Currency devalued; import license requirement eliminated.	Aug.	+ 39%	Apr.	+ 37%	.0600	—50%	Monetary policy is restrictive.	Costa Rica
Ecuador	Economic activity sluggish as result of policy restrictiveness and low oil-export price.	May	— 9%	11.0	1,321	Oct.	707	—18%	3.7	0	Weak non-oil export showing putting pressure on current account.	Sept.	+ 17%	June	+ 12%	.0310	—18%	Monetary stance becoming more restrictive.	Ecuador
El Salvador	Private investment fell 51% in 1980 and possibly even more last year.	June	—73%	3.4	709	Oct.	71	+ 1%	0.9	43	Sale of foreign exchange halted for travel abroad to stem capital outflow.	June	+ 15%	Aug.	0	.4050	0	Foreign reserves continue falling.	El Salvador
Guatemala	Oil output in 1982 could total 13,000 bpd, enough to satisfy over half domestic needs.	Dec. '80	+ 1%	7.9	800	Sept.	187	—62%	1.3	0	IMF approves two loans totaling about $110 million.	Aug.	+ 12%	July	+ 7%	Par	—	Liquidity is tight.	Guatemala
Jamaica	Bauxite prospects brightened by U.S., Soviet, and Venezuelan supply agreements.	Sept.	+ 7%	3.2	1,460	Sept.	79	—44%	0.6	468	Outlook for tourism favorable for winter season.	Sept.	+ 9%	Aug.	— 16%	.5700	0	Monetary stance is conservative.	Jamaica
Mexico	Industrial production up 7.6% in first seven months of 1981, versus 9.2% rise in year-earlier period.	June	+35%	167.0	2,300	Apr.	3,154	+37%	1.5	0	Agricultural exports up 32% in Jan.-Aug. 1981 vs. 4% decline year earlier.	Oct.	+ 28%	June	+ 34%	.0382	—13%	Demand for peso credit is strong.	Mexico
Nicaragua	Government returns approximately 900 coffee plantations to original owners.	Dec. '80	—22%	2.1	780	Dec. '80	70	—53%	1.0	24	Current-account gap may have narrowed to $300 mn. with cash crop revival.	Mar.	+ 25%	Dec.	+106%	.1000	0	Net foreign assets declining.	Nicaragua
Paraguay	Economic growth rate was 8%-9% in 1981, down from 11.4% in 1980.	Aug.	+19%	4.6	1,505	Oct.	772	+ 4%	16.9	0	Export receipts fell in 1981 because of lower commodity prices.	Apr.	+ 16%	Aug.	+ 9%	.00795	0	Domestic credit very limited.	Paraguay
Peru	Large public works program will get under way in 1982 and boost construction sector.	Sept.	—17%	17.2	965	Nov.	736	—62%	2.3	399	Higher rate of monthly sol/dollar devaluation in effect since September.	Nov.	+ 72%	Oct.	+ 48%	.0023	—34%	Reserve requirement being reduced gradually.	Peru
Puerto Rico	GDP to drop in fiscal 1982, reflecting U.S. recession, reduced federal transfers, and lower investment.	Sept.	+ 2%	11.4	3,530	Sept.	11,061*	+27%	—	—	Trade prospects dim in view of U.S. economic showing.	Oct.	+ 10%	Sept.	+ 14%	Par	—	Commercial bank deposits rose sharply in April-Sept. period.	Puerto Rico
Uruguay	Economic activity slows as exports drop.	Aug.	+32%	9.8	3,825	July	403	— 5%	3.0	0	Fiscal incentives offset overvalued exchange rate.	Oct.	+ 30%	Aug.	+ 33%	.0900	—17%	Net foreign assets declining.	Uruguay
Venezuela	Sugar industry in deep crisis; annual domestic production has plunged by over 50% since 1974.	Aug.	+18%	51.4	3,690	Nov.	3,401	+15%	8.4	0	Capital outflow significantly reduced since interest-rate adjustment.	Oct.	+ 13%	May	+ 14%	.2330	0	Domestic interest rates above international levels.	Venezuela

*Total bank deposits in commercial banks

World Interest Rates

market rates of Dec. 29, 1981; bond yields as of Dec. 25, 1981

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	12.00	17.25	13.8125* intervention rate	15.00	9.50	7.50	19.00 penalty rate 22.00	9.00	6.00	5.50
Day-to-Day Money	13.125 December 30	13.00	14.75	13.00	15.375	10.00	20.625	10.00	1.50	6.6875
Treasury Bills 91-day, Middle Rates	11.66 discount basis	14.70	14.875	16.00	16.09 one-year	n. a.	19.898 90-day	no dealing	no market	5.625 two-month
Commercial Paper prime, 3-month, asked	11.50 finance paper discount basis	15.75 finance paper 15% tax w/h	13.886	14.90 Certified	15.375 Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	12.70	15.60 15% tax w/h	14.875	14.90 Certified	not traded	9.90	24.60	no market	10.25	no market
Government Bonds Long-term, new and old issues, average yield	14.17	15.875	15.44*	11.11 20% tax w/h	15.85	9.17*	21.23	11.30	5.38	7.672
Industrial Bonds prime, long-term, new and old issues, average yield	15.10 Aa Industrials	16.50	16.38*	16.91	17.29	9.90*	20.92	12.92	6.50	7.16
Bank Short-Term Rate to Best Borrowers (prime rate)	15.75	16.50	15.50	18.00	16.85	14.00	22.50 ⅛ quar'ly fee on outstdng.	13.00	10.50	6.00
Bank Time Deposits 3-month	13.00 Cert. of Dep.	15.75	15.625	15.50	15.375	10.65	10.75	11.00 large deposits	8.75 residents only	4.25 20% tax w/h
Eurocurrencies 3-month, asked	14.1875	no market	16.125	no market	17.625	11.00	no market	11.0625	10.0625	no market
Exchange Rates—in U.S.$ rates floating against the $	—	.8446	1.9000	.0259	.1745	.4410	.000828	.4020	.5561	.00451
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	2.00 *D*	2.00 *D*	5.70 *D*	3.00 *D*	3.00 *P*	10.00 *D*	3.00 *P*	3.00 *P*	6.00 *P*

Eurodollar Deposits
(London, interbank, bid)
December 29

7-day	14.375
1-month	13.75
3-month	14.0625
6-month	14.8125

International Arbitrage
(3-month, hedged) + *in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	−1.011
U.S.-Canada Treasury Bills	− .328
U.S.-Canada Finance Co. Paper	−2.034
Eurodollars-U.K. Local Auth. Deposits	+ .5625

Eurobonds
(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	16.00
Over 7 yrs.	15.50
DM Bonds	
7 yrs. and under	10.00
Over 7 yrs.	9.50

Gold Price

London afternoon fixing

397.50
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.
Market rates as of Dec. 23; bond yields as of Dec. 18, 1981.

Current economic indicators of major industrial countries

	U.S.	Canada	Britain	France	Germany	Italy	Switzerland	Japan
Consumer prices*	9.6 (Nov.)	12.2 (Nov.)	12.0 (Nov.)	14.3 (Nov.)	6.6 (Nov.)	18.2 (Nov.)	7.0 (Nov.)	3.6 (Nov.)
Industrial production*	−1.8 (Nov.)	−1.5 (Oct.)	0.8 (Oct.)	−1.5 (Oct.)	−1.9 (Oct.)	−2.9 (Oct.)	−2.6 (March)	6.0 (Oct.)
Trade balance† *(billions of local currency units)*	−$4.41 (Nov.)	C$0.71 (Oct.)	£0.03 (Nov.)	−FF6.43 (Nov.)	DM3.95 (Nov.)	−Lit.0.41 (Oct.)	−SF0.26 (Nov.)	¥139 (Nov.)
Money supply (M1)*	4.5 (Nov.)	4.0 (Aug.)	10.2 (Aug.)	11.6 (June)	1.4 (Aug.)	11.2 (June)	−2.5 (July)	3.0 (Aug.)
Velocity of money (M1)*	12.7 (March)	6.7 (June)	10.2 (Dec. '80)	n. a.	1.3 (June)	4.5 (June)	n. a.	2.7 (June)
Reserves minus gold *($ million, change from previous month)*	540 (Oct.)	−194 (Oct.)	−162 (Oct.)	−172 (Oct.)	−3,177 (Oct.)	−190 (Oct.)	−1,402 (Oct.)	466 (Oct.)

* Percent change from 12 months earlier.

† Figures are only for the month indicated.

The U.S. Economic Outlook

The recession in U.S. economic activity gathered momentum late in 1981. Industrial production began to decline in August, and the rate of descent then accelerated. Unofficial estimates of total output (real GNP) for the fourth quarter indicate that it was no higher than two years earlier. A further decline is expected in early 1982, when the unemployment rate may exceed 9%. Only a few sectors of the economy currently show any real strength; defense spending is the principal example.

Nevertheless, there have been a number of encouraging developments in recent months. The sheer speed of the cutback in industrial production indicates that industry is moving vigorously to curb inventories—an essential part of the process that eventually ends recessions. Moreover, short-term interest rates have declined substantially, and the rate of price inflation shows signs of abating.

If the consensus view of the outlook is correct, the recession should hit bottom some time in the spring. The pace of recovery may be modest for the first few months. But, as of July 1, 1982, individual income tax rates will be reduced by 10%, and Social Security benefits (which are untaxed) will increase significantly, probably by 8%-9%. These are expected to generate a significant increase in personal consumption, which in turn should stimulate investment. Economic growth could therefore be vigorous in the second half.

For the next few months, however, news about U.S. production and income is likely to remain quite negative. Industrial output will continue to decline, reflecting the necessary adjustment of business inventories. Reductions in production activity will further erode income and limit consumption. Among the most obvious victims of this process will be—as in the past few months—sales of automobiles, especially domestic models. Although sales of U.S. models are near bottom now, material improvement is unlikely before spring. Sales of other consumer durables have also been badly undercut.

Residential real estate activity has been most severely depressed by the high interest rates of the past two years. Construction was probably begun on fewer than 1.1 million new housing units in 1981. Lower interest rates should bring some recovery, although with a considerable lag in view of the damage already wrought. For this reason, total housing construction may not be much higher in 1982 than in 1981. By year-end, however, the rate of new housing starts could easily be up by 30%-40%—but still about one quarter below the average for all of the 1970s.

Business capital investment has held up rather better than these other highly cyclical sectors, although it now appears to be slipping. Investment in 1982 will be subject to opposing influences. Among the negatives: the existence of substantial excess capacity (manufacturing's operating rate is now under 75%), and interest rates that, while down from their peaks, are still historically high. A strong plus: greatly improved depreciation rules and other incentives enacted last summer. On balance, the influences on investment imply modest weakness through much of 1982. Late in the year and in 1983, this sector could be expanding rapidly.

Because it is beginning at such low levels, 1982 promises to be unprepossessing; GNP and some of its key components, notably autos and housing, are likely to show little change from 1981. Viewed yearend to yearend, however, 1982 looks much more promising, with real growth of about 2½% forecast and the rate of consumer price inflation falling to around 7% from 9% in 1981.

Monetary policy and interest rates

Nominal economic growth in 1982 estimated at 9% (roughly 2% "real", with 7% inflation) suggests a strong likelihood that the Federal Reserve's announced money growth targets will come under pressure during the year. Accordingly, periods of rising interest rates are also in prospect for 1982.

Over time, money turnover, or velocity, has tended to rise by approximately 3½% annually. Assuming this trend figure, the narrow money stock would have to rise by 5½% to accommodate a 9% rise in U.S. GNP. Such growth is at the top of the Federal Reserve's announced 1982 target of 2½%-5½% growth. To be sure, a variety of factors could temper a collision between money targets and GNP growth—these include a more rapid velocity, a change of the targets, or simply an accommodation of more rapid growth by the Federal Reserve without higher interest rates.

Given the expectation of a relatively weak economy well into 1982, money demand should tend to be "manageable" by Federal Reserve standards for some months to come without sizable interest-rate movements in either direction. (This does not, of course, mean materially less short-run rate volatility.) On balance, there is some seasonal tendency for rates to move down early in the year, and 1982 should be no exception. In the latter part of the year, however, the spending rebound will mean accelerating money growth, with the result that interest rates are likely to rise—possibly sharply at times. For 1982 overall, money market rates, such as a federal funds and 90-day certificates of deposit, are expected to average in the neighborhood of 12%-14%, somewhat below the 16% average of 1981.

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As for financing activity, total credit-market borrowing will approximate $500 billion in 1982, about the same as in 1981. Residential mortgage activity will show little improvement until the second half, with overall volume only a bit better than the 1981 disaster. Consumer credit will also be marginally higher. The main swing factors are government borrowing—$20-30 billion higher than in 1981—and business financing, about $20 billion lower.

The business financing gap—investment and inventory outlays minus cash flow—is projected to narrow sharply in the first three quarters of 1982, rising toward the 1981 pace of $50 billion only late in the year. After bottoming out in the first quarter, both fixed investment and inventories should increase steadily as the recovery gets under way. Cash flow, aided by the larger available depreciation allowances, should decline less markedly early in the year, despite lower earnings, and should also respond quickly to the recovery in economic activity. Even if firms continue to build up liquid-asset positions at the same rate as in 1981, the outlook for total financing in 1982 will be approximately $85 billion, compared with $115 billion in 1981.

The distribution of these reduced credit demands is expected to emphasize more recourse to medium- and longer-term debt. Of course, this represents a reversal of the pattern that prevailed in 1981, when there was heavy use of short-term facilities such as bank loans and commercial paper. This shift is predicated on an improved investor interest in longer-maturity instruments as inflation rates show continuing signs of improvement. To be sure, the huge financing needs of the U.S. Treasury, combined with debt lengthening by business, will mean only modest declines at best in long-term bond yields in 1982.

U.S. current-account prospects

Last year witnessed a significant deterioration in the rate of growth of U.S. exports. Following the 21% increase in U.S. exports (f.a.s., census basis) registered in 1980, exports grew at less than the rate of inflation last year—by roughly 7%. Looking ahead, growth in inflation-adjusted exports is not expected to show a major improvement until late in 1982. The import scenario is rather similar. After expanding by about 17% in 1980, imports slowed considerably in 1981 as U.S. economic activity trailed off in the second half of the year. This year, the sluggishness is expected to continue until midyear when import orders could climb sharply, depending on the strength of the U.S. recovery. With stable oil prices and economic weakness at home and abroad, the outlook is for only moderate deterioration in the U.S. trade and current-account positions in 1982.

The modest deterioration seen, however, will be cushioned by the fact that the U.S. current-account balance in 1981 is estimated to have chalked up a surplus of more than $7 billion. While the trade position weakened slightly in 1981, improved services earnings gave the United States a strong surplus on current account while most of its trading partners were suffering deficits stemming from the oil price shock of 1979.

The performance of the U.S. current account in 1982 will depend greatly upon the relative strengths of the industrial world's economies. Although the industrialized economies are regaining strength, there is no locomotive force seen leading the world out of its current slump. Thus, it is likely that economic developments—both positive and negative—will keep the U.S. current-account position from changing dramatically over the next 12 months.

Import prospects are for non-oil imports to continue flat or possibly decline in real terms through the first half of the year. They should pick up sharply in the second half, however, resulting in nominal growth of 8%-9% for 1982 as a whole. Coupling this performance with flat oil-import growth in nominal terms yields an overall increase in imports of around 7%, a rate roughly comparable with the inflation rate projected for 1982.

On the export side, non-agricultural exports are expected to grow by less than the rate of inflation during the first half of the year before tending to accelerate in the second half. A sustained resurgence in non-agricultural exports, however, will have to await an increase in worldwide economic activity, particularly European, if they are to grow at a rate comparable with their pace during the export booms of 1979 and 1980. Agricultural exports are forecast to rise by a modest 7%-10% this year, depending upon weather both at home and abroad. Improvement, nonetheless, is likely in the U.S. agricultural-export position. On balance, the 1982 outlook for U.S. exports is less than rosy. Exports will do well to stay ahead of the growth in world inflation.

Summing up, the U.S. trade deficit is projected to grow only slightly to a little over $30 billion in 1982 from $28 billion in 1981. The services account will again be called upon to offset the merchandise trade gap and should be sufficiently in surplus to do so. Such imponderables as the timing of business cycles in the United States and abroad, OPEC price shocks, and newly imposed barriers to trade, however, could swing the balance one way or the other by as much as $6-8 billion. But the most likely prospect is that the various influences cited above will yield a slight current-account surplus for the United States in 1982.